# Federal Opportunity Zones: The newest gentrification tool?

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*Applied Research Paper*

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*Spring 2019 | Submitted to: Dr. Nancey Green Leigh*

# Table of Contents

## Executive Summary

The Federal Opportunity Zones tax incentive has taken over the conversation amongst professionals in the economic and community development world for the past year. The legislation sparked from a think tank exploring ideas about how to tap into a large amount of private capital – unrealized capital gains. With $6.1 trillion of unrealized U.S. capital gains, thought leaders imagined a mechanism to drive this source of private dollars into communities around the country that are most disinvested. Attempting to bridge the economic prosperity gap that is so prevalent in the U.S., the Federal Opportunity Zones were enacted.

This tax incentive is not the first place-based economic development tool invented. While different from preceding incentive programs, such as the New Markets Tax Credit program or the Brownfields incentives program, the intent of the program is similar. Therefore, there is much to be learned from past economic development tools aiming to utilize a private market to help our most vulnerable communities.

Thus far, the Federal Opportunity Zones legislation does not show much promise of mitigating possible consequences of place-based economic development tools, such as gentrification and displacement. This, complemented with the slow-moving regulations and the strict timelines of the program, is a public policy issue that needs to be addressed from an equity standpoint.

There are several issues with current legislation that can potentially result in more harm than good for those in which the incentive was designed to help. However, there is policy that can be, and must be, enacted in order to deliver benefits to those residents who hold the most stake in the matter.

# Introduction

The Federal Opportunity Zones tax incentive was created through the Tax Cuts and Jobs Act of 2017. The idea behind its inception was driven by the fact that there are over $6 trillion in U.S. capital gains essentially sitting on the sidelines. When people realize their capital gains in their investments, assets, stocks, etc., they must then pay substantial taxes on them. To avoid paying these taxes, people choose to hold their gains in an investment, rather than realize them and cash out. As a bipartisan effort to figure out how to utilize this large amount of private U.S. capital, the Federal Opportunity Zones incentive was created.

Posed as the newest and best economic development tool, the Federal Opportunity Zones created the newest place-based incentive for the wealthy to direct their capital to areas that are historically disinvested, poor, and in need of revitalization. Investors can realize their capital gains, reinvest them into a project or business located within a disinvested area, defer on their taxes, and potentially receive a discount on their taxes. On the other side, the project sponsors and business owners now have an incentive to locate within a disinvested area with a new source of potentially cheap capital, and the residents of the disinvested areas now get development that can potentially revitalize their neighborhoods. But, who decided that the residents want this type of investment? Will this investment be another driver for gentrification and inevitable displacement? With the current legislation and lack of complementary policy in place, the Federal Opportunity Zones could very well create more bad than good.

The purpose of my research is to analyze whether the new Federal Opportunity Zones incentive is being utilized to benefit our most distressed communities or are they just another gentrification tool. This incentive has huge potential to become the greatest and most impactful urban economic development incentive, but only if Congress addresses the need for thoughtful investments and does not allow investors to take advantage of the tool while communities see no benefit. Knowledge of the precedent for place-based economic development tools and their policy implications is important, so similar incentives will be discussed and compared. This research will follow the regulations while understanding how cities across the country are playing a role as well. My research will follow the types of investments being made and the types of investors and fund managers that become prevalent. Finally, this paper will conclude with a discussion on program design oversights and provide policy recommendations moving forward.

## How it Works

So, how does it all work, and who are the players? First, the investor can be anyone with any U.S. capital gains. Capital gains are the profits made when a person sells certain types of assets, including stock investments or real estate property.[1] The investors can also be large banks who have their own capital gains. These investors have 180 days from the realization of their gains to reinvest their capital into a Qualified Opportunity Fund (QOF). The QOF can be a corporation or a partnership that self certifies as such and is the vehicle in which these investments are made. This is important because someone cannot bypass the QOF, directly invest their capital gains

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[1] Amadeo, Kimberly. "Capital Gains Tax, Rates, and Impact." *The Balance.* 4 April 2019. https://www.thebalance.com/what-is-the-capital-gains-tax-3305824.

into a project, and receive the tax benefits. There is no minimum or maximum investment required to invest in or to establish a fund. The only current regulations for the QOF are that 90% of its assets must be invested into the Federal Opportunity Zones, and they cannot earn an operating revenue of greater than 5% of their total assets. So, it is likely that investors of the QOFs will also cash out on the excess operating revenue generated by the funds. Per the current regulations, the QOFs have 180 days from an investment to then deploy 90% of the capital into a project or business within a Qualified Opportunity Zone (QOZ).

There is not much existing regulation regarding what sorts of projects or businesses qualify for investment, other than having to be located within a QOZ and substantially improving the property. Even so, the definition of the term "substantially improve" is not definitively clear. Currently, there exists language within the regulations that defines "substantially improve" as the value of the property must increase by an amount equal to or more than the amount of the investment.[2] There is also some ambiguity regarding properties that are not completely within, or are adjacent to, designated zones. This has become an issue as a result of using census tract boundaries to designate QOZs. Per the current regulations "substantially all" of the property or the operations must be completely within the zone. Here, "substantially all" is currently defined as 70% of the property or operations.[3] These regulations are to help ensure that investment capital is being deployed into areas that they are intended per the incentive and that significant improvements are taking place.

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[2] United States. Dept. of the Treasury. Internal Revenue Service. *Investing in Qualified Opportunity Funds*. Washington: GPO, 2018, p. 5.
[3] Ibid., 26.

So, a QOF deploys investment into a qualified real estate project or operating business within a QOZ. Then, there are a few timelines that are associated with this incentive that both encourage long-term investment and a rush to deploy capital and begin development. The incentive was made available through the Tax Cuts and Jobs Act of 2017, so any capital gains that are realized on a 2017 or 2018 tax return are eligible to invest into a QOF.[4] As previously mentioned, however, if an investor wants to defer on his/her capital gains tax payment, he/she only has 180 days to reinvest their capital gains into a QOF, which then has another 180 days to deploy the money into a project or business. Therefore, the process for a development project or operation business to receive this new source of capital is relatively quick. The long-term nature of the investment comes with the increased amount of tax incentives that are made available to the investors the longer they hold their investment. If an investor holds her investment in the project or business for 5 years, then she receives a 10% step-up in her basis. This essentially means that only 90% of her original investment is taxable. If an investor holds her investment in the project or business for 7 years, then that basis steps up another 5%, so only 85% of the investor's original investment is taxable. If the investment is held for at least 10 years, then only 85% of the original investment is taxable, and any appreciation on the original investment can now be cashed out tax-free.[5]

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[4] *IRS.* "Opportunity Zones Frequently Asked Questions." 11, January 2019. https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions.

[5] United States. Dept. of the Treasury. Internal Revenue Service. *Investing in Qualified Opportunity Funds*. Washington: GPO, 2018, p. 32.

Regardless of when the original investment was made, however, investors who choose to reinvest their capital gains into a qualifying project or operating business must pay taxes on their original gains on December 31, 2026. This means that in order for the investor to receive the maximum 15% step-up in basis, she must invest her capital by December 31, 2019. This timeframe is becoming problematic because the regulations have yet to be finalized, but investors who want to make sure to receive these tax benefits are going to close transactions anyways without the finalized regulations. And in order for investors to do so comfortably, they are going to invest their capital into market-ready real estate projects that were going to happen anyway and are expected to give a high rate of return, even without this new source of capital.

## Example

An investor buys a house for $200,000 in 2008. In 2018, she sells her house for $1.2 million. This yields $1 million in capital gains. While the capital gains tax rate shifts regularly, let's assume that the tax rate is 25%. The investor is not prepared to pay $250,000 in taxes. So, instead, she invests her $1 million into a QOF. All the investor has to do to comply with the IRS is check a box on her 2018 tax return that states she is electing to defer paying her capital gains tax per the Federal Opportunity Zone legislation. The investor will have to check this box every year on her tax return, until she is ready to cash out her investment. On December 31, 2026, she will only have to pay capital gains taxes on $850,000, versus the original $1 million. So, assuming for simplicity that the tax rate is still 25%, she will have to pay $212,500, versus the original $250,000 tax payment. Three years later, her original $1 million investment doubles and is now worth $2 million. This means that the investor can cash out her investment at any time and not have to worry about paying any taxes on the $1 million appreciation.

## Who Benefits?

There is a huge carrot dangling in front of investors to invest their money into projects that can confidently provide a high rate of return. There is also a carrot dangling in front of developers and business owners to have access to a new source of capital if they can build, relocate, or expand into these disinvested neighborhoods. However, there exists an equity issue at the inception of the incentive. There is no policy to ensure that all QOZs receive the necessary amount of investment or the type of investment that benefits the residents and current business owners in the neighborhood. Additionally, a provision was created during designation that 25% of the QOZs could have up to 125% of the area median income (AMI) if they are adjacent to the census tracts that meet the baseline criteria: 20% poverty and/or 80% AMI.[6] Therefore, several neighborhoods that are already gentrifying have been designated as QOZs. Investors, especially when the regulations are taking a while to be finalized and timelines are to be met, are going to put their capital into these neighborhoods. These are the “goldilocks neighborhoods,” as will be discussed later. They are not too disinvested that there is no other development or activity occurring, but they are not already past the point of gentrification that their rate of return would not be as high. They are those neighborhoods that are right on the cusp of development – those neighborhoods where development would happen

[6] *Fundrise.* “What are Opportunity Zones and How Do They Work?” https://fundrise.com/education/blog-posts/what-are-opportunity-zones-and-how-do-they-work.

anyways, and there exists a high probability of generating a favorable rate of return. But, circling back to why this program was designed in the first place, was this the original intention? The thought leaders at the Economic Innovation Group created this model as a way for money that is not being touched anyways to find its way into neighborhoods that could really use the investment.[7] However, the designations and regulations speak to another purpose: the same winners, winning yet again.

## Literature Review

### Public-Private Partnerships

In the Tax Cut and Jobs Act of 2017, the newest economic development tool and first tax incentive in over 15 years was introduced. The Federal Opportunity Zones were created to drive private investment into our nation's most distressed neighborhoods. This program creates an incentive for investors to invest their recently realized capital gains into qualified census tracts in exchange for a deferral on their capital gains tax, as well as the potential to hold their investment with tax-free appreciation after 10 years. Public-Private Partnerships (PPPs) have been utilized throughout the nation for the past almost two decades. Further, while the Federal Opportunity Zones program is not the first initiative which utilizes place-based tax incentives as an economic development tool, there are some significant differences from past practice that significantly increase the program's potential impact. In order for such PPPs to be successful when financing urban economic development projects, properly preparing, sharing a vision,

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[7] *Economic Innovation Group.* "Opportunity Zones: History." https://eig.org/opportunityzones/history.

understanding the risks and rewards, securing consistency, communicating often, and building trust are crucial in the process.[8] Whether or not the Federal Opportunity Zones will create an impact that will in fact benefit our communities in the way they were intended will be studied and explored throughout this paper. This literature review will set the background for the main purposes of exploration and will lay out some preliminary insight on the program thus far.

## New Markets Tax Credits

A couple of examples of PPPs that have been implemented to drive private investment in distressed areas in the past include the New Markets Tax Credit (NMTC) program and the Brownfields incentives programs. The NMTC program was enacted in 2000 as a gap financing tool to bring development projects to fruition while creating quality jobs in low-income communities. Similar to Federal Opportunity Zones, the NMTC program is part of a bipartisan effort to encourage private investment and economic growth in low-income urban and rural areas. There is typically a lack of conventional lending and overall investment in these underutilized areas, and the NMTC program was created as a PPP to ease the flow of patient capital to generate economic growth and encourage the financing of long-term community and economic development.[9]

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[8] Corrigan, Mary Beth, et al. "Ten Principles for Successful Public/Private Partnerships." *Urban Land Institute.* 2005. http://uli.org/wp-content/uploads/2005/01/TP_Partnerships.pdf.

[9] Rapoza Associates, *New Markets Tax Credit Economic Impact Report (2003-2015).* Report to the New Markets Tax Credit Coalition. New Markets Tax Credit Coalition, December 2017.

As an incentive, investors who choose to invest in qualified low-income communities via NMTCs receive a cumulative reduction in their federal income taxes, which is applied over a seven-year period.[10] The seven-year period is important because as previously mentioned, the program seeks to encourage long-term and patient capital. Therefore, investors must hold a stake for seven years. This idea parallels the goal to drive long-term private investment into Federal Opportunity Zones.

In evaluating the success of the NMTC program, additional outcomes, such as amenities, services, and facilities are also considered. While the NMTC program has generated strong bipartisan support over the years and has proven successful overall, there is a lack of certain regulation and data collection that should be performed in order to effectively and accurately evaluate success.[11] In finalizing the regulations regarding the Federal Opportunity Zones incentive, there is much to learn here. For example, more detailed local studies should be performed that develop industry benchmarks by project types and assets, distinguish quality of jobs, and generate project-specific data. Furthermore, a community-wide study to define who benefits from which outcomes is necessary for effective assessment, and a longer-term impact analyses would help researchers gain a better understanding of project evolution. Researching program design and implementation, as well as monitoring public policy issues will help answer questions that inquire on the effectiveness and relevance of the NMTC program.[12]

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[10] Abravanel et. al, *New Markets Tax Credit (NMTC) Program Evaluation.* Prepared for U.S. Department of Treasury Community Development Financial Institutions (CDFI) Fund. Metropolitan Housing and Community Centers: Urban Institute, (2).

[11] Abravanel, Martin et. al. "New Markets Tax Credit (NMTC) Program Evaluation: Final Report." *Urban Institute*. April 2013.

[12] Ibid.

Requiring this level of regulation and data collection is necessary to implement when finalizing the regulations of the Federal Opportunity Zone program.

## Brownfields Tax Incentive

The Brownfields incentives program is administered locally and is used to attract private development interest for involvement in brownfield remediation. This program parallels the Federal Opportunity Zone program in that market incentives encourage the private sector to become involved. Noticing that developers respond to insurance and tax incentives, administrative regulations are necessary in making sure the incentives are used such that private investment is attracted while creating development that benefits the community as is intended. Brownfields programs are similar place-based, incentive-driven investment programs with similar concerns regarding PPPs.[13]

Introduced in 1997, the Brownfields tax incentive aims to incentivize development in areas that are not as economically feasible as greenfields. Utilizing the incentive allows for fully-deductible environmental cleanup costs in the year in which they are occurred, ensuring development activity.[14] By offsetting cleanup costs, the Brownfields tax incentive can enhance a project's cash flow, making the development process financially feasible. This assumption suggests that without integrating the tax incentive into the project's capital stack, the project would not be developed. Are these public incentives associated with PPPs driving private investment in otherwise unattractive

[13] Eckerd, Adam and Roy L. Heidelberg. "Public Incentives, Market Motivations, and Contaminated Properties: New Public Management and Brownfield Liability Reform." *Public Administration Review.* 75, no. 2. (2014): 252-261.
[14] "A Guide to Federal Tax Incentives for Brownfields Redevelopment." *United States Environmental Protection Agency.* (2011): 1-3.

redevelopment opportunities, or are they simply making profitable opportunities even more profitable?

## Gentrification and Displacement

The several players involved in the Federal Opportunity Zones program include investors, fund managers, developers, business owners, real estate owners, and government officials. These players must efficiently work with local stakeholders, community members, and councilmembers in order to effectively generate the sort of social impact that is made possible with this new tax incentive. Speaking to the potential positive impact that could be generated, there is a massive amount of money that can be driven into our low-income communities. This money could create quality jobs, more local services, attract other businesses, and can improve the quality of life in distressed neighborhoods. Or, this money could attract big companies that will drastically increase the land values in low-income communities with no regard for the residents that live in those communities. This money could also attract businesses without consulting the means or the needs of the residents and could result in isolation of community members. The concern of gentrification with the Federal Opportunity Zones is a large one, and it is quite valid.

When discussing gentrification, it is crucial to stress the importance of neighborhoods in all stages of life. Gentrification can affect residents starting at youth and will stay with people throughout their lifetime. In urban areas where income inequality is severe, efforts to increase economic mobility are extremely important in allowing for growth within our communities. A recent *New York Times* article discusses a study performed by the Seattle Housing Authority, which researched the economic fortunes of children in almost all neighborhoods in America. The research revealed a relationship between the neighborhoods children live in and whether they prosper as adults. “Some places lift children out of poverty. Others trap them there. Now cities are trying to do something about the difference.”[15] This research led to a publication of nationwide data that makes it possible to identify where children of all economic backgrounds have the most favorable odds to prosper as adults. This article and research introduce a discourse on how to properly utilize this data. Stating the issue of local economic disparities around the country, the researchers suggest that this data be used to maximize the impact that could be seen from the Federal Opportunity Zones incentive. This study and the neighborhood data is pertinent to analyzing Federal Opportunity Zones as an effective place-based economic development tool.

While the negative effects of gentrification must be mitigated throughout place-based economic development initiatives, development is inevitable. There is much literature stressing the importance of knowing how to boost community development while controlling gentrification. For example, getting to know the community members and local business owners is an easy first step in fighting gentrification, and creating some transparency in the process will create trust between residents and developers. Another important way to boost community development while tackling gentrification is to maintain public domains, such as parks, schools, libraries, and community centers.

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[15] Badger, Emily and Quoctrung Bui. “Detailed New National Maps Show How Neighborhoods Shape Children for Life.” *New York Times.* October 1, 2018. https://www.nytimes.com/2018/10/01/upshot/maps-neighborhoods-shape-child-poverty.html.

The privatization of such land takes away public services that help sustain a quality of life needed by residents. Land trusts are being utilized to maintain such efforts; keeping close contact with advocates and councilmembers can be helpful in the process. Protecting existing and demanding new construction of affordable housing is extremely important in neighborhoods with threats of gentrification. Increased rents are a quick by-product of new developments and can easily create a situation where residents can no longer afford to live in their homes. Growing income inequality and a growing gap between supply and demand of affordable housing in urban areas are trends that follow rising rents. More affordable housing will help alleviate this issue.[16] Thoughtful investments must be made within Federal Opportunity Zones in order to ensure positive impacts for our local communities and neighborhoods.

Research has been conducted in order to provide insight on how to mitigate displacement in developing communities. To do so, an important distinction must be made between gentrification and displacement. Furthermore, there are several factors to gentrification that generate different types of displacement: a jobs/housing imbalance in which jobs outstrips housing, tight housing markets in which there is a constricted supply, relative affordability compared to surrounding areas, targeted public sector or private sector investment, high or increasing traffic congestion and commutes, and renewed interest in urban life and amenities. Furthermore, displacement can occur either directly or indirectly to both residents and commercial entities.[17]

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[16] Chadburn, Melissa. “5 Tactics That Fight Gentrification While Boosting Community Development.” *Everyday Feminism.* July 26, 2017. https://everydayfeminism.com/2017/07/fight-gentrification-for-community/.

[17] “Preventing Displacement Policy Fact Sheet.” *Preventing Displacement.* November 2007. http://www.greatcommunities.org/wp-

There is a fair amount of concern over the gentrification that could result from the Investing in Opportunity Act. From an investment stand point, it is likely that most Opportunity Fund investors are not interested in the social impact that their investment could create. Rather, they are mainly concerned about generating a return on their capital investment. A recent *The Atlantic* article describes the ideal area to invest in as "Goldilocks-type places." That is, as previously mentioned, it is not ideal to invest in areas that have already seen a spike in land value, and it is too risky to be the first to invest in the most distressed areas that would not attract investment and development otherwise. The areas sought-after are those that are not quite gentrified, but are right on the cusp of taking off any minute.[18] These areas would likely see investment anyways, which defeats the purpose of the inception of Federal Opportunity Zones. For example, a city like Fresno, CA is just a morning drive away from the Bay Area's technology hub, but is not seeing nearly the amount of investment and is suffering from poverty. However, it's the cities like Fresno that are ripe for investment, and Federal Opportunity Zones could be the tool to incentivize development. However, public policy issues arise when incentivizing these types of private capital investments. As previously mentioned regarding the effectiveness of the NMTC program, not much comparison has been reported on the program's net effect on investment or its benefits to local residents. Is

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content/uploads/pdf/2007%2011%20Preventing%20Displacement%20Policy%20Fact%20Sheet.pdf.

[18] Lowrey, Annie. "Fixing America's Forgotten Places." *The Atlantic.* July 24, 2018. https://www.theatlantic.com/ideas/archive/2018/07/how-do-we-help-this-place/565862/.

this investment simply shuffled capital, or is this incentive in fact increasing new investment? The fear of gentrification holds a precedent within other market-driven, place-based economic development initiatives.

## Federal Opportunity Zones Thought Leaders

As previously mentioned, the Federal Opportunity Zones incentive was created as a place-based initiative within the Tax Cut and Jobs Act, which is a part of the Investing in Opportunity Act passed by the 115th Congress. This Act amended the Internal Revenue Code to authorize the designation of Federal Opportunity Zones in low-income communities. The purpose of the Federal Opportunity Zones is to provide tax incentives for investments in the zones, including deferring the payment of capital gains taxes on capital that is reinvested in the zones.[19]

The selection process in designating the Federal Opportunity Zones was administered by U.S. Congress, but they received suggestions from each state Governor. Each Governor received help and input from local development agencies and government officials to recommend census tracts for eligibility.  As represented in Figure 1, roughly 8,700 census tracks throughout the United States received designation.[20]

[19] Investing in Opportunity Act, H.R. 828, 115th Cong. (2017).
[20] Price, Dennis. "Here are the 8,700 census tracts certified as Opportunity Zones." *Impact Alpha. 18 June 2018.* https://impactalpha.com/here-are-the-8700-census-tracts-certified-as-opportunity-zones/.

**Figure 1. U.S. Designated Federal Opportunity Zones**

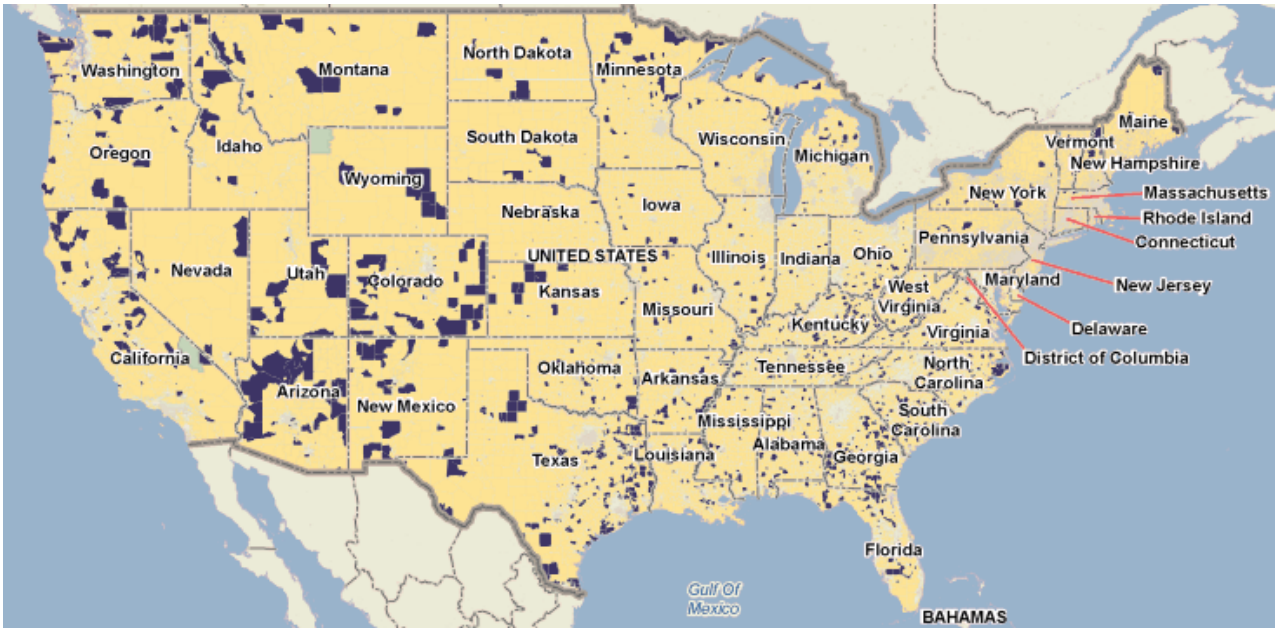


*Image Source: Policy Map*

In order for the selection and development process of the Federal Opportunity Zones to have made sense, the issues of social need, market traction, maximizing impact for low-income residents, PPPs, and data collection should have been addressed.[21] However, the only criteria for designation was for census tracts to have at least 20% poverty and/or average household incomes at or less than 80% AMI. And, as previously mentioned, there existed provisions to include adjacent tracts that expand these criteria.[22]

[21] Katz, Bruce and Jeremy Nowak. "Guiding Principles for Opportunity Zones." *Commissioned for the Governance Project.* Accessed August 2018. https://www.novoco.com/sites/default/files/atoms/files/guiding_principles_for_opportunity_zones_new_localism_040418.pdf.

[22] *Fundrise.* "What are Opportunity Zones and How Do They Work?" https://fundrise.com/education/blog-posts/what-are-opportunity-zones-and-how-do-they-work.

Similar to the NMTC program, the Federal Opportunity Zones design has generated a large amount of bipartisan support. Republican U.S. Senator Timothy Scott and tech billionaire Sean Parker helped drive the Investing in Opportunity Act, which estimated $6.1 trillion of profits on American balance sheets that could be utilized to revitalize and develop distressed communities.[23]

The Economic Innovation Group (EIG) is a think tank that aims to assist entrepreneurs and investors in creating a more dynamic economy throughout the country. The EIG developed the concept for Federal Opportunity Zones in 2015 to help address persistent poverty and uneven recovery that have "left too many American communities behind."[24] "Officially called the Investing in Opportunity Act, it promises to pump a massive amount of cash into America's most impoverished communities by offering wealthy investors and corporations a chance to erase their tax obligations."[25] What is meant by "most distressed" and "most impoverished", as well as how the Federal Opportunity Zones incentive works, is discussed below.

Now that the census tracts designated Qualified Opportunity Zones are finalized, these tracts are locked in until December 2026. While the final regulations are still being

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[23] Bertoni, Steven. "An Unlikely Group Of Billionaires And Politicians Has Created The Most Unbelievable Tax Break Ever." *Forbes.* July 18, 2018. https://www.forbes.com/sites/forbesdigitalcovers/2018/07/17/an-unlikely-group-of-billionaires-and-politicians-has-created-the-most-unbelievable-tax-break-ever/.

[24] "Opportunity Zones: A new national community investment program that connects private capital with low-income communities across America.' *Economic Innovation Group.* Accessed August 2018. https://eig.org/opportunityzones/history.

[25] Bertoni, Steven. "An Unlikely Group Of Billionaires And Politicians Has Created The Most Unbelievable Tax Break Ever." *Forbes.* July 18, 2018. https://www.forbes.com/sites/forbesdigitalcovers/2018/07/17/an-unlikely-group-of-billionaires-and-politicians-has-created-the-most-unbelievable-tax-break-ever/.

negotiated, there is a lot of flexibility regarding what is an appropriate investment. All that is settled thus far is that the investment must generate “substantial improvement,” which as previously mentioned, has yet to be definitively defined.

## Proposed Regulations

As of October 19, 2018, the U.S. Treasury Department released the first tranche of regulations for the Federal Opportunity Zones program. While these rules provide some clarity on how investors can qualify for the tax incentive through real estate investments, there are still unanswered questions on top of a list of potential issues that could occur during implementation. Steve Rosenthal discussed the proposed regulations in a recent *Forbes* article, and he expressed a concern for what those will mean for communities. One proposed regulation would permit investors to continue to claim tax benefits until 2048, even though the Tax Cut and Jobs Act only designates Qualified Opportunity Zones through 2028. Another would allow Qualified Opportunity Funds to make investments into businesses where a minimum of only 70% of its assets, or “tangible property” is located within the Qualified Opportunity Zones. While this would create flexibility to invest in operating businesses, it would allow for more dollars to leak to more affluent communities where a share of the business’s asset may be held.[26]

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[26] Rosenthal, Steve. “IRS Proposes Generous Rules For Opportunity Zone Investors, But What Will They Mean For Communities?” *Forbes.* October 23, 2018. https://www.forbes.com/sites/stevenrosenthal/2018/10/23/irs-proposes-generous-rules-for-opportunity-zone-investors-but-what-will-they-mean-for-communities/#64ec9a367ff1.

Another significant regulation would require investors to spend at least as much to improve a property as they paid for it, but this only applies to buildings and not to the underlying land value. This regulation could be taken advantage of in the community's benefit. For example, a fund could rehab a strip of abandoned homes to create more affordable housing. The community would benefit because the fund would not need to include the land costs to determine whether its investment meets the improvement requirements. Or, this could tempt funds to invest in, say, a parking lot. Doing nothing more than repairing the parking attendant's shed would satisfy the improvement requirements under the currently proposed regulations. The investors will get a significant tax break, and the community will gain nothing. As the regulations are currently proposed, there is nothing to ensure that the investments will benefit low-income communities or their residents.[27]

According to the initial tranche of regulations, the Federal Opportunity Zones investments will occur within the private market. Qualified Opportunity Funds and individual investors can simply indicate on their tax forms that they have invested their capital gains into qualifying projects or businesses. While there are other compliance requirements, such as funds having 90% of their assets invested into QOZs, the administration and reporting measures have not been clearly defined.

On March 12, 2019, the second tranche of regulations was submitted to the Office of Information and Regulatory Affairs for review.[28] While the first set of guidance suggested regulations for real estate investments, the second round of regulations is

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[27] Ibid.

[28] Atkinson, Jimmy. "Treasury official answers questions on Opportunity Zones regulations." *OpportunityDb: The Opportunity Zones Database.* 8 April 2019.

intended to clarify how this incentive may work for investments in operating businesses. Daniel Kowalski, counselor to the Treasury Secretary, expects that the second tranche of regulations to be ready for public comment by end of April.[29] According to Walter Davis, founding member of Peachtree Providence Partners, the second tranche will provide more information regarding compliance measures.[30]

Even so, there is no evidence that suggests the IRS is preparing to monitor and audit the use of the Federal Opportunity Zones incentive, other than investors complying with their tax forms, and there is no government agency currently responsible for collecting impact data. During the Coasis Coalition Opportunity Zone Super Conference, Daniel Kowalski suggested that there may be a third set of regulations released later this year that will react to abuse of this incentive.[31] However, there is currently a gap in reporting and data collection that will need to be filled by the research and public policy community. As previously mentioned, there will be regulations regarding the fund's compliance with amount of investment; however, unlike previous place-based economic development tools, the regulations are not expected to address any sort of impact data requirements. So, how will policy makers, thought leaders, and economic development professionals know whether or not this new tax incentive is generating the outcomes intended? Local leaders and organizations should work with the public policy and research community to think innovatively about how they can collect impact data to support the evaluation of the Federal Opportunity Zones incentive.

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[29] Ibid.
[30] Davis, Walter. (2019 April). Meeting.
[31] Atkinson, Jimmy. "Treasury official answers questions on Opportunity Zones regulations." *OpportunityDb: The Opportunity Zones Database.* 8 April 2019.

## What are Cities Doing?

When the buzz of the Federal Opportunity Zones began to circulate, cities and economic development agencies around the country started to scramble to figure out how to play a role. Several major cities went through different methodologies to determine what tracts they wanted to be designated within their cities, and they lifted these recommendations up to their respective Governor's offices. Others, like Portland, Oregon, left this process up to the neighborhood associations. Either way, no city wanted to be left behind. Even so, cities are racing to be the continuous front runner in this new tax incentive game. Figure 2 provides socioeconomic characteristics for the case studies discussed below.

**Figure 2. Socioeconomic Characteristics**

| | **Population Size** | **% Population Change since 2010** | **Per Capita Income** | **% Poverty** | **Unemployment Rate (2018)** |
|---|---|---|---|---|---|
| *Erie, PA* | 97,369 | -4.5 | $20,175 | 26.8 | 4.6% |
| *Portland, OR* | 647,805 | 9.6 | $36,492 | 16.2 | 3.1% |
| *Baltimore, MD* | 611,648 | -1.5 | $28,488 | 22.4 | 5.6% |
| *Atlanta, GA* | 486,290 | 13.6 | $40,595 | 22.4 | 3.9% |

*Data Source: U.S. Census Bureau (2017)*

## Erie, Pennsylvania

For the small City of Erie, Pennsylvania, population 97,369[32], this tax incentive could not have come at a more opportune time. According to Brett Wiler, Director of Capital Formation at Pennsylvania's Flagship Opportunity Zone Development Company, Erie's industrial market is growing tremendously, and the city is now in a position to utilize public, private, and philanthropic stakeholders in their efforts to maximize their eight Federal Opportunity Zones.

**Figure 3. Erie, Pennsylvania Designated Opportunity Zones**

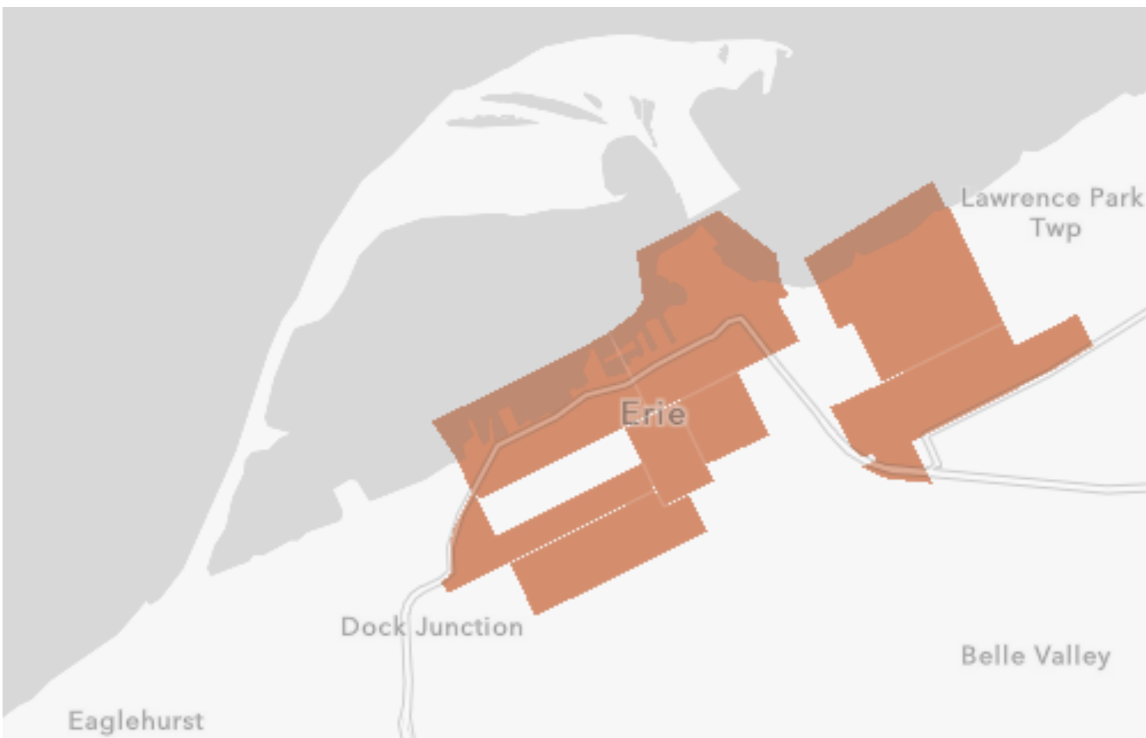


*Image Source: Economic Innovation Group*

[32] "Erie, Pennsylvania Population 2019." *World Population Review. http://worldpopulationreview.com/us-cities/erie-pa-population/.*

Their strategy is to market their city to attract investors. To do so, they are following the thought process of Bruce Katz, accomplished academic and co-founder of New Localism Advisors, a firm which aims to help cities design, finance and deliver transformative initiatives that promote inclusive and sustainable growth.[33] Katz has created a model for a city-wide investment prospectus. The prospectus is intended to identify the sub-markets that exist within the city and to map them according to anchor institutions, like universities or hospitals.[34] Ultimately, a local economic analysis is performed, and the prospectus is the means for telling the story of the City of Erie.

Wiler shared that once the sub-markets are identified, a development company under the Erie chamber plans to highlight "shovel-ready" projects and attract a wide range of investors. Their idea is to play match-maker between investors and projects. When suggesting tracts for designation, the City did so by ensuring that there are other incentives, such as tax abatements and Enterprise Zones, available to help attract investment. The City of Erie is also considering expediting zoning and permitting or waiving fees for developments within Federal Opportunity Zones.[35]

Although gentrification is not as hot a topic in such a small city, the underlying issue is still prevalent throughout developing implementation strategies. The City of Erie envisions their philanthropic partnerships as a means to invest in those deals that "generally" have a significant social impact.[36] Is this enough? And more importantly, is

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[33] *The New Localism.* "Bruce Katz." https://www.thenewlocalism.com/bruce-katz/.
[34] Katz, Bruce. "Opportunity Zones: Maximizing Impact in Atlanta." Speaker Series, 4 December 2018, Loudermilk Conference Center, Atlanta, GA.
[35] Wiler, Brett. (2018 October). Telephone interview.
[36] Ibid.

this sustainable? Depending on the philanthropic sector to enable socially-minded developments throughout a long-term federal program may be a risky solution.

## Portland, Oregon

Portland's thought process behind recommending census tracts for designation differs from most other cities. With deep concerns over gentrification, and the imminent equity issues associated with this tax incentive, Portland decided to be hands-off from the beginning.[37] Troels Adrian, Business and Industry Team Manager at Prosper Portland, Portland's economic and urban development agency, shared that as an agency, they deliberately took a neutral stance because of the concerning program design. Instead, Prosper Portland educated neighborhood-based organizations about Federal Opportunity Zones early on and left it up to them to decide if they wanted to recommend their tract for designation. This resulted in the most disadvantaged neighborhoods electing not to participate, out of fear of gentrification or displacement. Rather, the entire downtown core of Portland, along with all its expensive waterfront property, won designation for this tax incentive. Furthermore, Portland does not intend to track investments or maintain any sort of data because they "do not have a stake in it."[38] Consequently, the designated zones in Portland do not reflect the original intent of the program – incentivizing private capital investments into areas that otherwise would not be attractive.

[37] Adrian, Troels. (2019, February 5). Telephone interview.
[38] Ibid.

**Figure 4. Portland, Oregon Designated Opportunity Zones**

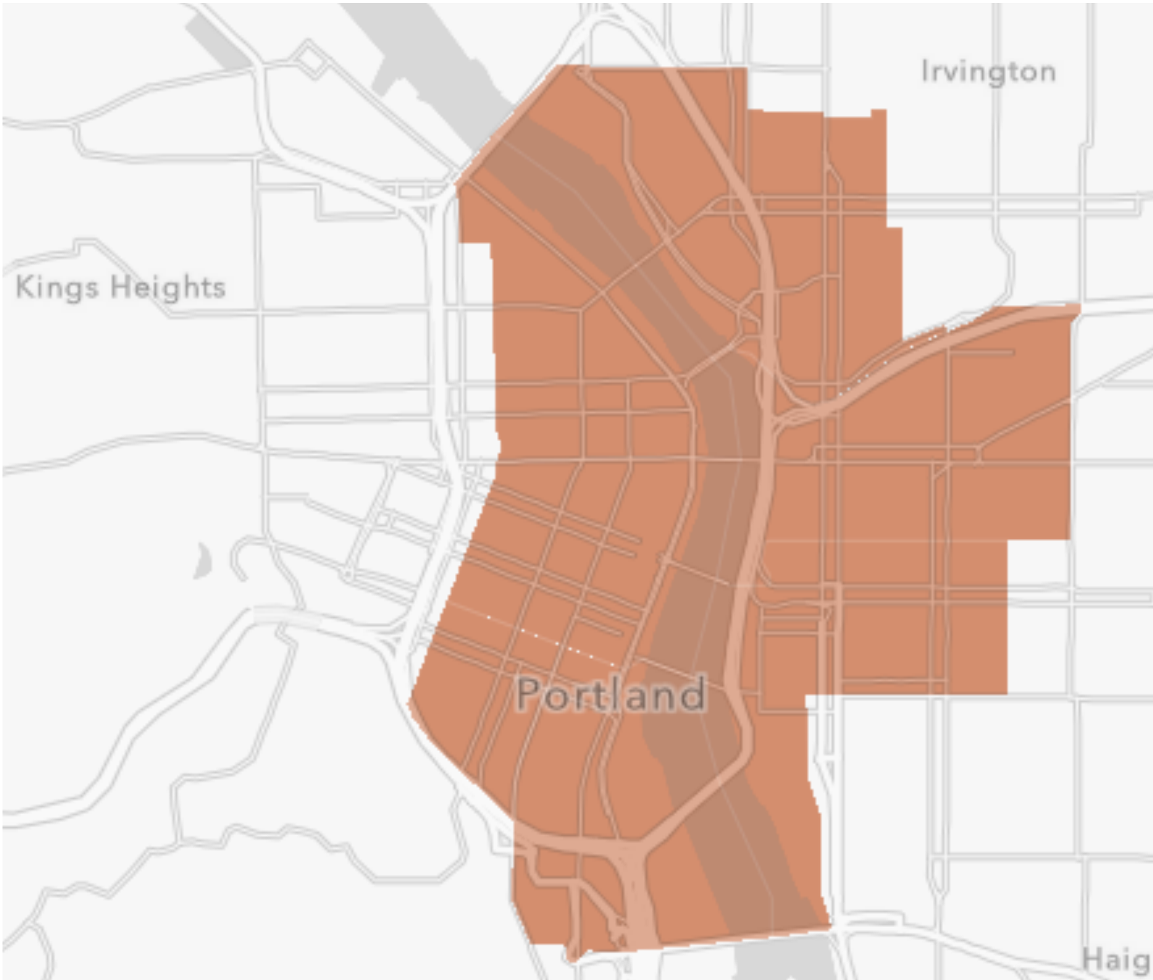


*Image Source: Economic Innovation Group*

The fear of gentrification was voiced in a very general manner, and there are no plans currently to mitigate these concerns. While the idea to utilize existing incentives to development public benefits on city-owned land, such as affordable housing and entrepreneurship, is being considered, development partners to execute these plans have not been determined.[39] Adrian shared that Greater Portland, Inc. (GPI) has hired a

[39] Ibid.

private consultant to promote projects in these popular neighborhoods. There is a demand for housing on the coast, and GPI plans to syndicate several waterfront properties and market as a single deal to potential investors. “The amount of high-value real estate in Portland’s opportunity zones is unfathomable.”[40] While the hard conversations regarding critical public policy issues are still being developed at the Federal level, GPI is purposefully marketing the high-return, low-hanging fruit for investors.

## Baltimore, Maryland

For the Baltimore Development Corporation (BDC), the goal from the inception of Federal Opportunity Zones was to maximize investment while also maximizing community benefits and community impacts.[41] According to Ben Seigel, the BDC’s Opportunity Zones Coordinator, the methodology for recommending tracts for designation in Baltimore involved a thoughtful analysis of eligible tracts by the city. The first step in analyzing the census tracts that would be eligible was concentrating and clustering zones around key economic anchors, such as universities and hospitals, and then around key business and industrial areas, such as incubators and waterfront. Then, the BDC aligned those zones with key neighborhood investment areas within the city. That is, those neighborhoods that are currently undergoing development or are on the rise to undergo such development and investment.[42] The BDC aimed to be strategic and fair on the balance of how many zones to select, since states could only designate

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[40] Ibid.
[41] Seigel, Ben. (2019, March 13). Telephone interview.
[42] Ibid.

25% of their tracts. Seigel shared that Baltimore proposed 41 tracts to the Governor's office and were granted 38 of those in addition to four others. The designated tracts in Baltimore comprise 28% of all Maryland's designated tracts.

**Figure 5. Baltimore, Maryland Designated Opportunity Zones**

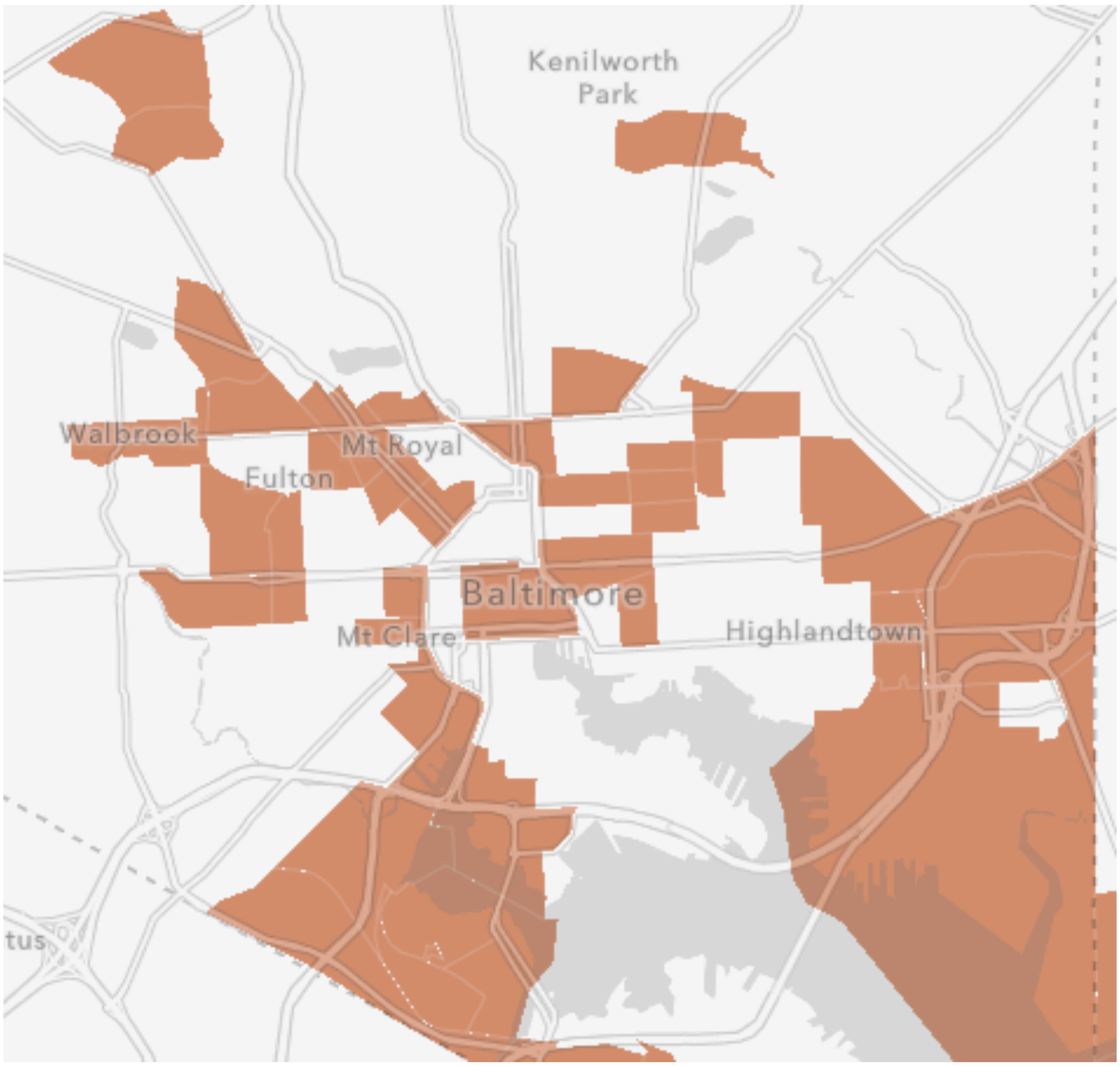


*Image Source: Economic Innovation Group*

Post designation, Maryland is proposing state-wide incentives for businesses, rather than QOFs, that could potentially help track investments, as well as generate some community benefits through development.[43] Per the proposed state-wide policy, if the amount of Opportunity Zone investment is publicly reported, then the business will receive a level of increase of Maryland state tax credits per employee. If the business complies with the reporting, then they may opt to also incorporate a Community Benefits Agreement (CBA) into their development or expansions plans. Doing so will further increase their state tax credits per employee.[44] According to Seigel, this legislation is currently undergoing the approval process and could potentially be in effect July 1, 2019. Other state-wide policies proposed for Maryland include over $50 million in funding for an Opportunity Zone task force, grants for training programs, and affordable housing funds.

The BDC specifically hired Ben Seigel to focus on tracking investments throughout the city. Furthermore, he has also been working on community outreach, education, and engagement. Being active in the community as an external face, as well as being highly accessible, is important for this role. As expected, there are mixed feelings throughout the community regarding the Federal Opportunity Zones incentive. In addition to concerns about gentrification and displacement, there are concerns regarding how equitable investments will be.[45] Seigel shared that there are a diverse range of Opportunity Zones and, knowing some neighborhoods will have higher returns than others, the hope is to see investment across all of them.

[43] Seigel, Ben. (2019, March 13.) Telephone interview.
[44] Ibid.
[45] Ibid.

To help mitigate gentrification, Seigel is thinking about what cities can do to enhance beneficial projects. The Neighborhood Impact Investment Fund, a new community development loan fund, has been created to help bridge the gap for Opportunity Zone investment. To complement this effort, Baltimore is aiming to work within local communities to connect neighborhood associations in advocating for CBAs. Seigel expressed that part of the challenge lies in the “misunderstanding of who the protagonists are.” To him, developers and project sponsors should be seen by the community as the protagonist entities that are going to be partners with the community to have inclusive economic development.

Ultimately, the capital provided by Opportunity Zone investments is not the only part of the developments’ capital stacks, and it’s a lot of the same developers working together. The Opportunity Zone incentive is merely providing a new source of capital to be infused with what already exists. For communities to see developments that generate benefits, Seigel expressed that cities must work with developers and provide additional resources and incentives that will allow for the riskier deals to become financially feasible.[46]

## Atlanta, Georgia

Atlanta became involved with the Federal Opportunity Zones incentive early on, and Invest Atlanta, Atlanta’s Development Authority, took the role of recommending census tracts within the city for designation. According to Eloisa Klementich, President and CEO of Invest Atlanta, the thought process behind this method was project-

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[46] Ibid.

focused.[47] With Invest Atlanta's mission already being that of promoting development that benefits both the city and its local communities, Invest Atlanta's priority projects were located in highly distressed areas of the city.[48] Gentrification and displacement mitigation is a daily effort by the authority, so strategically recommending tracts with other community development initiatives was a part of the method.

Post designation, the city is pleased with the result of their recommendations. As seen in Figure 6, the tracts are concentrated on the south side of Interstate-20 and on the west side of Downtown, both of which are high priority areas for Atlanta's current mayor because of the spatial economic inequalities that exist on Atlanta's south side and west side. Educating local stakeholders and being a direct point of contact regarding this new incentive is important for Invest Atlanta. The agency held an informational workshop for local business owners, entrepreneurs, developers, investors, council members, and other city officials to learn about the incentive and to provide a platform where stakeholders can ask questions. Invest Atlanta continuously works to reach out to local developers and entrepreneurs, participate in informational panels, and is collaborating with other organizations to attract socially-minded investment.

[47] Klementich, Eloisa, "Qualified Opportunity Zones: What Are They? What Benefits Do They Provide?" 12 March 2019, Two Alliance Center, Atlanta, GA.
[48] *Invest Atlanta.* "About Us." https://www.investatlanta.com/about-us/what-we-do.

**Figure 6. Atlanta, Georgia Designated Opportunity Zones**

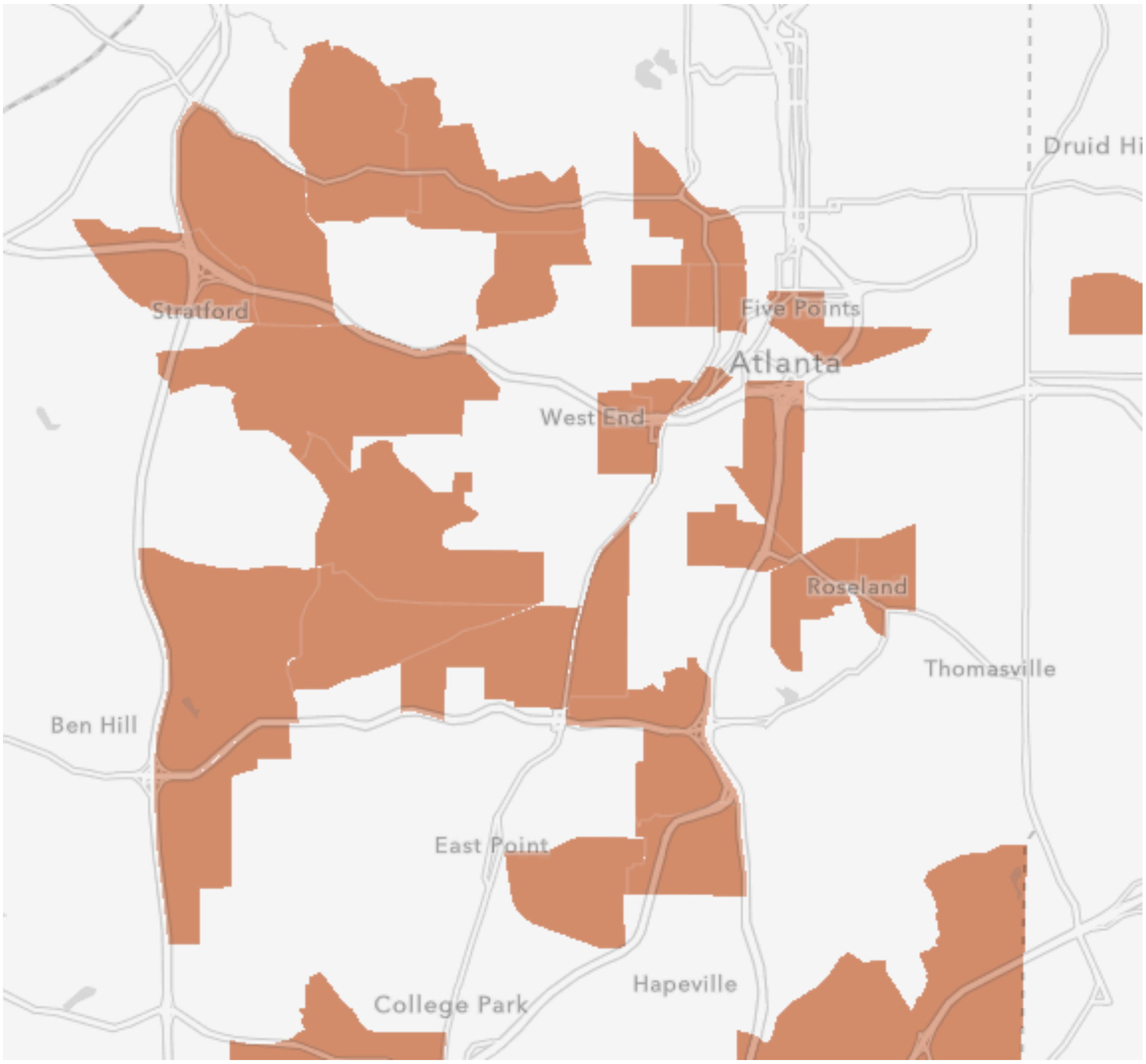


*Image Source: Economic Innovation Group*

In November 2018, Invest Atlanta released a Request for Qualifications for established Opportunity Funds to partner with to invest in socially-minded projects throughout the city.[49] The agency received 11 responses, several of which were

[49] Klementich, Eloisa, "Qualified Opportunity Zones: What Are They? What Benefits Do They Provide?" 12 March 2019, Two Alliance Center, Atlanta, GA.

national, and all of which are dedicating their funds to projects that deliver benefits such as affordable housing, healthy food initiatives, small business expansion, minority entrepreneurship, and community-serving commercial corridors. While Invest Atlanta realizes that there are no policies in place to prevent the same major players investing in market-driven projects, the agency intends to support, lift up, and direct investment to those socially-minded projects that can allow the Federal Opportunity Zones incentive to benefit those neighborhoods that were intended to benefit.[50]

## Current Activity

On the project side of this incentive, cities do not want to miss the opportunity for projects within their local jurisdictions. Similarly, national investors do not want to miss the boat on investing their capital gains into fruitful projects. In fact, the National Council of State Housing Agencies (NCSHA) has released an Opportunity Zone Fund Directory that lists over 100 Qualified Opportunity Funds that have raised funds upwards of $750 million and have identified specific asset classes and locations in which they are interested in investing.[51]

As seen through local incentives and initiatives happening throughout major U.S. cities, immediate investor interest has generated a lot of attention. According to Novogradac & Co. LLP, a national accounting firm that is actively following Federal Opportunity Zone investment activity, seventeen state legislatures have considered

[50] Ibid.
[51] "Opportunity Zone Fund Directory." *NCSHA.* 4 April 2019. https://www.ncsha.org/wp-content/uploads/2018/11/Opportunity-Zone-Fund-Directory-Current.pdf.

Opportunity Zone bills, including proposals for additional tax breaks, to lure investors and encourage certain projects.[52] Michael Novogradac states, “through the added incentives, states can encourage the type of development they want to see in opportunity zones.” However, there is not much evidence suggesting that states are working efficiently with their local jurisdictions to facilitate legislation. This creates two issues: one, states are not as capable as cities and counties in assessing the needs of their residents, and two, cities and counties may have more power over development than states. For example, last year the City Council in Boulder, Colorado halted all development in its zones because of the lack of proper planning.[53]

As previously mentioned, the strict timeframe for investors to invest their capital gains into projects by December 31, 2019 has generated quick investments into projects that did not necessarily need the investment to come to fruition. Jody Wiser, executive director of Tax Fairness Oregon, a nonprofit pushing to eliminate Oregon’s additional incentives for Opportunity Zones, warns that “most of the money will be spent where money was going to be spent anyway.” As seen in Figure 3, the entirety of downtown Portland received designation, and according to Wiser, there are zones in downtown Portland that are already filling up with big office buildings and trendy restaurants.[54]

The fear of gentrification and displacement is imminently becoming a reality throughout the entire country. According to a Zillow study reported by World Property

[52] Quinton, Sophie. “Opportunity Zones Spur New State Tax Incentives.” *Stateline.* 3 April 2019.
[53] Ibid.
[54] Ibid.

Journal, property sales prices in Opportunity Zones have risen by 20% since their designation in April 2018.[55] Furthermore, Zillow analysts suggest that a large portion of investment is flowing towards those neighborhoods and communities that are already in the process of growth, even without the tax incentive. The study incorporated factors such as population growth, income growth, and transaction volume to rank Opportunity Zones based on their likely appeal to investors. In fact, the majority of the country's top 50 most enticing zones for investors have already seen major growth since 2010, when the income data used to designate Opportunity Zones was gathered.[56]

## Oversights and Policy Recommendations

While the potential positive benefits of the Federal Opportunity Zones tax incentive cannot be ignored, there are a few oversights in program design that could, unless supplemented with proactive policies, result in inequitable investments, gentrification, and displacement. The first oversight of design occurred during the program's inception. That is, a lack of community engagement and education resulted in neighborhoods being blind-sided and now having to play catch-up to ensure they do not feel negative consequences. While some cities are an exception, as seen throughout discussion with Troels Adrian of Prosper Portland, the majority of neighborhoods were not involved at all in the designation process. Rohit Malhotra and Kyle Kessler, Founder and Policy and Research Director, respectively, of Atlanta's Center for Civic Innovation

[55] Rothstein, Matthew. "Property Values in Opportunity Zones Have Risen 20%" *Bisnow East Coast.* 5 April 2019.
[56] Ibid.

(CCI), shared their thoughts regarding the Federal Opportunity Zones incentive and what it means for local entrepreneurs. CCI serves as a local civic leader, focuses on promoting equitable public policy, and provides programming for local entrepreneurs. According to Malhotra and Kessler, the inception of the Federal Opportunity Zones tax incentive lacked a grass roots, neighborhood-level effort in educating and involving citizens in the process. This oversight, along with the vagueness and yet to be finalized regulations of the program are extremely problematic for local business owners and residents trying to figure out how they can benefit from this economic development tool that was intended to help the disadvantaged.[57]

Another oversight of program design is the lack of Opportunity Fund certification by the U.S. Treasury. As the current regulations state, a corporation or partnership may "self-certify" as a Qualified Opportunity Fund.[58] This differs from economic development tools that serve as precedent, such as the New Markets Tax Credit (NMTC) program. To receive allocation in the NMTC program, a certified Community Development Entity (CDE) must submit a thorough application explaining specific intents of their transactions, and furthermore, CDEs are evaluated on an annual basis per reporting requirements enforced by U.S. Treasury.[59] The Federal Opportunity Zones regulations, however, do not require any reporting.

Given these oversights, there are several downsides of the Federal Opportunity Zones regulations as they currently stand. First, the lack of initial community

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[57] Kessler, Kyle and Rohit Malhotra. (2019, March 1). Telephone interview.
[58] *IRS.* "Opportunity Zones Frequently Asked Questions." 11, January 2019. https://www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions.
[59] Abravanel, Martin et. al. "New Markets Tax Credit (NMTC) Program Evaluation: Final Report." *Urban Institute*. April 2013.

engagement and education from inception creates a basis of distrust of both local and federal authorities. Now, communities must work backwards to advocate for their neighborhoods to fight for positive outcomes from this incentive. Second, there is a very real risk of displacement of residents due to an untargeted influx of new private capital, especially in the country's most distressed areas that house our most vulnerable populations. Designed as a tax cut for the nation's wealthiest, a lack of protective policies increases this risk. Third, local Community Development Financial Institutions are having to compete with larger national financial institutions that lack the local knowledge and understanding of impacted communities.[60] Fourth, the lack of reporting requirements yields no tangible data with which to assess the program and ensure its outcomes reflect the original intent of inception. Finally, the current flexibility of the program and its lack of finalized regulations raise concerns for equitable investments. Without finalized regulations, and especially given the upcoming timelines, investors will naturally invest in the areas that are less risky and that probably do not need this place-based incentive to attract investment. Furthermore, investors and fund managers are unable to structure the more complicated and risky deals, and local jurisdictions may have trouble syndicating and marketing socially-minded projects that need the incentive to justify the deal structure.

However, there are several policies that could be utilized to mitigate the issues that may occur as a result of program design oversights. Allowing local and state governments to create additional guidelines, tailored to their jurisdiction, will help ensure

[60] *PolicyLink.* "Opportunity Zones – Guiding Principles and Perspectives. http://www.policylink.org/node/52161.

that Opportunity Zone investments benefit local communities and help prevent gentrification and displacement caused by unthoughtful development. More so, local guidelines should ensure that developments promote and create living wage jobs, healthy communities, and access to affordable housing and transportation options, health-care facilities, healthy food and other amenities to increase the quality of life in the most distressed neighborhoods around the country.[61]

The addition of reporting requirements is a must for the upcoming regulations. Without data to support the outcomes of the program, there is no way to ensure that the Federal Opportunity Zones are benefitting those intended. Specific measures should be monitored, such as jobs created, number of affordable housing units created, investments in minority-owned and women-owned businesses, vacant structure repurposing, and critical services made available to vulnerable communities.[62] Furthermore, Opportunity Funds should go through an application process to report their intent for investments, especially with the proven success of preceding federal tax programs. These policy recommendations are not only feasible, but they are necessary to ensure equitable investments that generate benefits to our disadvantaged and most vulnerable communities around the country.

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[61] *PolicyLink.* "Recommendations for Opportunity Zones: Leveraging private investment for equitable economic development." http://www.policylink.org/sites/default/files/PolicyLink%20Recommendations%20for%20Opportunity%20Zones%20.pdf.

[62] Ibid.

## Conclusion

The analysis presented here does not reject the possibility that the Federal Opportunity Zones tax incentive has the power to generate positive benefits in our country's most disinvested neighborhoods. The amount of capital that is eligible to be invested into Opportunity Zones can make a significant difference for a lot of people. However, the lack of supplemental policy, along with the faint amount of community engagement that has been practiced nationwide, is concerning. History provides a precedent for ensuring that place-based economic development benefits are reaching those intended, and the lessons learned and best practices developed can not be ignored in today's economy. The economic prosperity gap across the country needs to be addressed, and increased economic mobility must be both an intention and a result of economic development tools. If the recommended policies to supplement the strength of the Federal Opportunity Zones tax incentive are enacted, then there is hope that this tax incentive could bridge the gap between our invested and disinvested communities and generate an equitable quality of life for our most vulnerable communities.

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